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SEPT. 30, 2004



MONTANA LOTTERY

FINANCIAL STATEMENTS  
(Unaudited)

September 30, 2004

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MONTANA LOTTERY

FINANCIAL STATEMENTS  
(Unaudited)

September 30, 2004

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## APPOINTIVE OFFICIALS

Gerald J. LaChere, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

## LOTTERY COMMISSION

## TERM EXPIRES

|                 |          |                 |
|-----------------|----------|-----------------|
| Clifford Brophy | Columbus | January 1, 2005 |
| Donald Sterhan  | Billings | January 1, 2005 |
| Tom Keegan      | Helena   | January 1, 2006 |
| Betty Wilkins   | Missoula | January 1, 2006 |
| Robert Crippen  | Butte    | January 1, 2007 |

## REPORT DISTRIBUTION

According to Section 23-7-202(9), MCA, copies of this report must be distributed to the following:

Governor - Judy Martz  
Acting Director of Dept. of Administration – Steve Bender  
Legislative Auditor - Scott Seacat  
President of the Senate – Bob Keenan  
Speaker of the House – Doug Mood

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature".

The President of the Senate and the Speaker of the House have requested that this report be distributed to the following committees:

### HOUSE – State Administration Committee

Debby Barrett, Chair  
Dee Brown, Vice Chair Majority  
Larry Jent, Vice Chair Minority  
Norman Ballantyne  
Arlene Becker  
Sue Dickenson  
Carol Gibson  
Dan Hurwitz  
Hal Jacobson  
Larry Lehman

Ralph Lenhart  
Alan Olson  
Bernie Olson  
Don Roberts  
Clarice Schrupf  
Frank Smith  
Pat Wagman  
Jonathan Windy Boy  
Cindy Younkin

### HOUSE – Business & Labor Committee

Joe McKenney, Chair  
Don Steinbeisser, Vice Chair Majority  
Jim Keane, Vice Chair Minority  
Bob Bergren  
Rod Bitney  
Sylvia Bookout-Reinicke  
Nancy Rice Fritz  
Dave Gallik  
Kathleen Galvin-Halcro

Ray Hawk  
Bob Lawson  
Rick Maedje  
Gary Matthews  
Scott Mendenhall  
Penny Morgan  
Allen Rome  
Sandy Weiss  
Bill Wilson

### SENATE – State Administration Committee

John Cobb, Chair  
Mike Sprague, Vice Chair  
Kelly Gebhardt

Carolyn Squires  
Mike Wheat

### SENATE – Business & Labor Committee

Dale Mahlum, Chair  
Mike Sprague, Vice Chair  
Sherm Anderson  
Vicki Cocchiarella  
Kelly Gebhardt  
Bob Keenan

Sam Kitzenberg  
Ken Hansen  
Glenn Roush  
Don Ryan  
Carolyn Squires  
Fred Thomas

# Montana Lottery

September 2004

## Montana Lottery Commission:

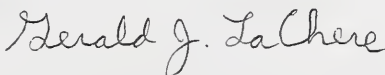
The Lottery will transfer \$1,464,472 to the General Fund as a result of operations in the first quarter of fiscal year 2005 compared to \$1,954,747 for the same time period last year. Powerball sales were down by \$1.2 million for the quarter because of the large jackpots of \$200 million and \$240 million experienced in July 2003 and not in this year. Scratch tickets and Montana Cash had small decreases while Wild Card and Hot Lotto had increased sales. Qwik Tix were not available for the first quarter of fiscal year 2004 and had sales of \$125,379 in this year.

Direct game costs were consistent with sales for the quarter. Slight differences between product prize percentages in the two quarters are due to two factors: 1) the reverted prizes in fiscal year 2004 was \$32,000 more in scratch tickets and \$37,000 less in on-line reverted prizes than in 2005; and 2) the fact that Qwik Tix has a higher prize percentages than the other on-line games. Net operating revenue for the quarter was 30.1% of revenue compared to 31.8% last year.

Total operating expenses for the quarter of \$995,788 were slightly lower as opposed to last year's quarterly total of \$1,031,840 for a difference of \$36,052. An expense category that had a significant increase is Advertising Production, which includes making all of the Powerball, Public Service Announcement and image spots for the year.

Fiscal year 2005 is beginning slowly; however, we are hopeful that high jackpots, as we have experienced in the past, will happen later in the year. In addition, if necessary we will attempt to curtail expenses, where possible, to meet our General Transfer goal for the year.

Sincerely,



Gerald J. LaChere  
Director



**MONTANA LOTTERY**  
**STATEMENT OF NET ASSETS**  
**September 30, 2004 and 2003**  
**(UNAUDITED)**

|                                         | Period Ended<br>September 30, 2004 | Period Ended<br>September 30, 2003 |
|-----------------------------------------|------------------------------------|------------------------------------|
| <b>ASSETS:</b>                          |                                    |                                    |
| <b>CURRENT ASSETS</b>                   |                                    |                                    |
| Cash and Cash Equivalents               | \$ 154,585                         | \$ 230,948                         |
| Receivables (Net)                       | 1,285,306                          | 1,095,268                          |
| Inventories                             | 837,819                            | 789,475                            |
| Other Current Assets                    | <u>29,765</u>                      | <u>29,198</u>                      |
| <b>TOTAL CURRENT ASSETS</b>             | <b>2,307,475</b>                   | <b>2,144,889</b>                   |
| <b>NONCURRENT ASSETS</b>                |                                    |                                    |
| Computer, Furniture & Equipment         | 5,563,836                          | 5,589,216                          |
| Accumulated Depreciation                | (4,156,075)                        | (3,310,795)                        |
| Software, net of Amortization           | 246,429                            | 410,714                            |
| Multi-State Receivable                  | <u>1,353,842</u>                   | <u>1,688,484</u>                   |
| <b>TOTAL NONCURRENT ASSETS</b>          | <b>3,008,032</b>                   | <b>4,377,619</b>                   |
| <b>TOTAL ASSETS</b>                     | <b>\$ <u>5,315,507</u></b>         | <b>\$ <u>6,522,508</u></b>         |
| <b>LIABILITIES:</b>                     |                                    |                                    |
| <b>CURRENT LIABILITIES</b>              |                                    |                                    |
| Accounts Payable                        | \$ 380,990                         | \$ 373,570                         |
| Estimated Prize Liability               | 1,381,666                          | 1,398,294                          |
| Due to Primary Government               | 493,577                            | 6,576                              |
| Transfer Obligations                    | 1,464,472                          | 1,954,747                          |
| Deferred Revenue                        | 96,812                             | 80,846                             |
| Current Portion Comp. Absences          | 112,270                            | 104,347                            |
| Current Portion Long-Term Debt          | 0                                  | 837,648                            |
| Other Current Liabilities               | <u>6,500</u>                       | <u>0</u>                           |
| <b>TOTAL CURRENT LIABILITIES</b>        | <b>3,936,287</b>                   | <b>4,756,028</b>                   |
| <b>NONCURRENT LIABILITIES</b>           |                                    |                                    |
| MUSL Prize Liability                    | 1,307,113                          | 1,688,484                          |
| Accrued Compensated Absences            | <u>72,107</u>                      | <u>77,996</u>                      |
| <b>TOTAL NONCURRENT LIABILITIES</b>     | <b>1,379,220</b>                   | <b>1,766,480</b>                   |
| <b>TOTAL LIABILITIES</b>                | <b>5,315,507</b>                   | <b>6,522,508</b>                   |
| <b>NET ASSETS</b>                       |                                    |                                    |
| Unrestricted Net Assets                 | <u>0</u>                           | <u>0</u>                           |
| <b>TOTAL LIABILITIES AND NET ASSETS</b> | <b>\$ <u>5,315,507</u></b>         | <b>\$ <u>6,522,508</u></b>         |

The accompanying notes are an integral part of these financial statements.

**MONTANA LOTTERY**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS**  
**FOR THE QUARTERS ENDED SEPTEMBER 30, 2004 and 2003**  
(Unaudited)

|                                             | Quarter Ended<br>September 30, 2004 | Quarter Ended<br>September 30, 2003 |
|---------------------------------------------|-------------------------------------|-------------------------------------|
| <b>OPERATING REVENUES:</b>                  |                                     |                                     |
| Scratch ticket revenue                      | \$ 2,423,729                        | \$ 2,593,257                        |
| Powerball revenue                           | 3,411,773                           | 4,678,775                           |
| Montana Cash revenue                        | 835,215                             | 907,290                             |
| Wild Card revenue                           | 551,164                             | 548,802                             |
| Hot Lotto/Rolldown revenue                  | 794,151                             | 633,925                             |
| Qwik Tix revenue                            | 125,379                             | 0                                   |
| License, permits, and misc                  | 900                                 | 655                                 |
| Total Operating Revenues                    | 8,142,311                           | 9,362,704                           |
| Less Direct Game Costs:                     |                                     |                                     |
| Scratch ticket prize expense                | (1,479,615)                         | (1,562,978)                         |
| On-line ticket prize expense                | (2,869,705)                         | (3,309,584)                         |
| Retailer commission                         | (460,819)                           | (536,883)                           |
| Cost of tickets sold                        | (189,270)                           | (177,311)                           |
| Vendor fees                                 | (689,734)                           | (796,894)                           |
| Net Operating Revenue                       | 2,453,168                           | 2,979,054                           |
| <b>OPERATING EXPENSES:</b>                  |                                     |                                     |
| Advertising                                 | 74,531                              | 92,761                              |
| Advertising Production                      | 87,126                              | 27,706                              |
| Audit Fees                                  | 1,655                               | 21,147                              |
| Bad Debts Expense                           | (425)                               | (45)                                |
| Communications                              | 20,469                              | 18,878                              |
| Contractual Services                        | 31,846                              | 62,256                              |
| Depreciation and Amortization               | 267,308                             | 265,562                             |
| Interest Expense                            | 0                                   | 11,809                              |
| Administrative Service Fee                  | 13,580                              | 13,572                              |
| State Cost Recovery                         | 3,317                               | 1,523                               |
| Multi-State Dues                            | 88,856                              | 91,967                              |
| Public Relations                            | 3,518                               | 2,485                               |
| Other                                       | 5,483                               | 3,889                               |
| Personal Services                           | 343,229                             | 362,343                             |
| Repairs and Maintenance                     | 4,915                               | 3,812                               |
| Supplies and Materials                      | 18,563                              | 25,335                              |
| Travel                                      | 5,637                               | 1,275                               |
| Utilities and Rent                          | 26,180                              | 25,565                              |
| Total Operating Expense                     | 995,788                             | 1,031,840                           |
| Operating Income                            | 1,457,380                           | 1,947,214                           |
| <b>NONOPERATING REVENUES (EXPENSES)</b>     |                                     |                                     |
| Interest earnings                           | 7,092                               | 7,533                               |
| Gain/Loss on sale of asset                  | 0                                   | 0                                   |
| Total Nonoperating Revenues(Expenses)       | 7,092                               | 7,533                               |
| Income Before Operating Transfers           | 1,464,472                           | 1,954,747                           |
| Operating Transfers In (Out) - General Fund | (1,464,472)                         | (1,954,747)                         |
| CHANGE IN NET ASSETS                        | 0                                   | 0                                   |
| Total Net Assets, Beginning of Period       | 0                                   | 0                                   |
| TOTAL NET ASSETS, END OF PERIOD             | 0                                   | 0                                   |

The accompanying notes are an integral part of these financial statements.

**MONTANA LOTTERY**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET FUND ASSETS**  
**AND RECONCILIATION OF BUDGET AND ACTUAL (BUDGETARY BASIS) TO GAAP BASIS**  
**FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004**  
(Unaudited)

|                                                | <u>Budget</u><br>Fiscal Year<br>July 1, 2004 -<br>June 30, 2005 | <u>Actual</u><br>Three Months Ended<br>September 30, 2004<br>(Unaudited) | Actual as a<br>Percent of<br>Final Budget<br>(%) |
|------------------------------------------------|-----------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------|
| <b>REVENUES:</b>                               |                                                                 |                                                                          |                                                  |
| Scratch ticket revenue                         | \$ 10,300,000                                                   | \$ 2,423,729                                                             | 23.53                                            |
| Powerball revenue                              | 17,000,000                                                      | 3,411,773                                                                | 20.07                                            |
| Montana Cash revenue                           | 4,200,000                                                       | 835,215                                                                  | 19.89                                            |
| Wild Card revenue                              | 2,300,000                                                       | 551,164                                                                  | 23.96                                            |
| Hot Lotto revenue                              | 2,350,000                                                       | 794,151                                                                  | 33.79                                            |
| Qwik Tix revenue                               | 500,000                                                         | 125,379                                                                  | 25.08                                            |
| License, permits, and miscellaneous            | 2,000                                                           | 900                                                                      | 45.00                                            |
| Total Revenues                                 | <u>36,652,000</u>                                               | <u>8,142,311</u>                                                         | 22.22                                            |
| <b>DIRECT GAME COSTS:</b>                      |                                                                 |                                                                          |                                                  |
| Prizes - Scratch ticket                        | 6,077,000                                                       | 1,479,615                                                                | 24.35                                            |
| Prizes - Lotto games                           | 12,738,000                                                      | 2,796,485                                                                | 21.95                                            |
| Prizes - Qwik Tix                              | 310,000                                                         | 73,220                                                                   | 23.62                                            |
| Retailer commissions                           | 2,156,500                                                       | 460,819                                                                  | 21.37                                            |
| Ticket cost - scratch games                    | 721,000                                                         | 189,270                                                                  | 26.25                                            |
| Ticket cost - vendor fees                      | 3,060,275                                                       | 689,734                                                                  | 22.54                                            |
| Total Direct Game Costs                        | <u>25,062,775</u>                                               | <u>5,689,143</u>                                                         | 22.70                                            |
| <b>OPERATING EXPENSES:</b>                     |                                                                 |                                                                          |                                                  |
| Advertising                                    | 582,688                                                         | 74,531                                                                   | 12.79                                            |
| Advertising Production                         | 203,770                                                         | 87,126                                                                   | 42.76                                            |
| Audit Fees                                     | 37,983                                                          | 1,655                                                                    | 4.36                                             |
| Communications                                 | 83,500                                                          | 20,469                                                                   | 24.51                                            |
| Contractual Services                           | 366,713                                                         | 31,846                                                                   | 8.68                                             |
| Administrative Service Fee                     | 54,318                                                          | 13,580                                                                   | 25.00                                            |
| State Cost Recovery                            | 14,245                                                          | 3,317                                                                    | 23.29                                            |
| Multi-State Dues                               | 115,502                                                         | 88,856                                                                   | 76.93                                            |
| Public Relations                               | 35,950                                                          | 3,518                                                                    | 9.79                                             |
| Other                                          | 32,655                                                          | 5,483                                                                    | 16.79                                            |
| Personal Services                              | 1,463,089                                                       | 337,829                                                                  | 23.09                                            |
| Repairs and Maintenance                        | 25,402                                                          | 4,915                                                                    | 19.35                                            |
| Supplies and Materials                         | 197,125                                                         | 18,563                                                                   | 9.42                                             |
| Travel                                         | 36,607                                                          | 5,637                                                                    | 15.40                                            |
| Utilities and Rent                             | 112,242                                                         | 26,180                                                                   | 23.32                                            |
| Equipment                                      | 48,735                                                          | 0                                                                        | 0.00                                             |
| Total Operating Expenses                       | <u>3,410,524</u>                                                | <u>723,505</u>                                                           | 21.21                                            |
| Operating Income                               | 8,178,701                                                       | 1,729,663                                                                | 21.15                                            |
| <b>NONOPERATING REVENUES (EXPENSES):</b>       |                                                                 |                                                                          |                                                  |
| Interest Earnings                              | 0                                                               | 2,243                                                                    |                                                  |
| Loss on Sale on Asset                          |                                                                 | 0                                                                        |                                                  |
| NET INCOME (BUDGETARY BASIS)                   | \$ 8,178,701                                                    | \$ 1,731,906                                                             | 21.18                                            |
| <b>RECONCILIATION OF BUDGETARY/GAAP BASIS:</b> |                                                                 |                                                                          |                                                  |
| 1. Capitalized equipment purchases             | 48,735                                                          | 0                                                                        | 0.00                                             |
| 2. Adjustment for compensated absences         |                                                                 | (5,400)                                                                  |                                                  |
| 3. Adjustment for depreciation expense         | (1,068,861)                                                     | (267,308)                                                                | 25.01                                            |
| 4. Bad Debts                                   |                                                                 | 425                                                                      |                                                  |
| 5. MUSL interest earnings                      | 50,000                                                          | 4,849                                                                    | 9.70                                             |
| Total Reconciling Items                        | (970,126)                                                       | (267,434)                                                                |                                                  |
| NET INCOME (GAAP BASIS)                        | \$ 7,208,575                                                    | \$ 1,464,472                                                             | 20.32                                            |

The accompanying notes are an integral part of these financial statements.

**MONTANA LOTTERY**  
**ANALYSIS OF REVENUES AND EXPENSES BY PRODUCT**  
**FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004**  
**(UNAUDITED)**

|                                        | SCRATCH      | POWERBALL    | MONTANA CASH | WILD CARD  | HOT LOTTO  | QWIK TIX   | ADMIN     |
|----------------------------------------|--------------|--------------|--------------|------------|------------|------------|-----------|
| REVENUES:                              | \$ 2,423,729 | \$ 3,411,773 | \$ 835,215   | \$ 551,164 | \$ 794,151 | \$ 125,379 | \$ 900    |
| DIRECT GAME COSTS:                     |              |              |              |            |            |            |           |
| Prize Expense                          | 1,479,614    | 1,625,438    | 499,808      | 284,811    | 386,428    | 73,221     | 0         |
| Retailer Commissions                   | 173,205      | 170,841      | 41,768       | 27,565     | 39,714     | 7,726      | 0         |
| Cost of Tickets Sold                   | 189,270      | 0            | 0            | 0          | 0          | 0          | 0         |
| Vendor Fees                            | 202,270      | 292,397      | 70,871       | 46,714     | 67,013     | 10,469     | 0         |
| NET OPERATING REVENUE                  | 379,370      | 1,323,097    | 222,768      | 192,074    | 300,996    | 33,963     | 900       |
| OPERATING EXPENSES:                    |              |              |              |            |            |            |           |
| Advertising                            | 11,594       | 49,129       | 3,613        | 3,613      | 3,613      | 2,838      | 131       |
| Advertising Production                 | 10,604       | 34,049       | 10,606       | 10,606     | 10,606     | 10,604     | 51        |
| Audit Fees                             | 0            | 0            | 0            | 0          | 0          | 0          | 1,655     |
| Bad Debts                              | 0            | 0            | 0            | 0          | 0          | 0          | (425)     |
| Communications                         | 11,825       | 224          | 224          | 224        | 224        | 93         | 7,655     |
| Contractual Services                   | 1,327        | 148          | 148          | 148        | 148        | 12,584     | 17,344    |
| Depreciation and Amortization          | 75,602       | 113,038      | 27,863       | 18,373     | 26,363     | 4,330      | 1,739     |
| Interest                               | 0            | 0            | 0            | 0          | 0          | 0          | 0         |
| Administrative Service Fee             | 4,601        | 1,435        | 1,053        | 692        | 688        | 686        | 4,425     |
| State Cost Recovery                    | 0            | 0            | 0            | 0          | 0          | 0          | 3,317     |
| Multi-State Dues                       | 0            | 11,428       | 0            | 25,057     | 11,679     | 0          | 40,662    |
| Public Relations                       | 188          | 720          | 720          | 720        | 720        | 300        | 150       |
| Other                                  | 149          | 2            | 2            | 2          | 2          | 2          | 5,324     |
| Personal Services                      | 116,291      | 36,265       | 26,620       | 17,494     | 17,389     | 17,326     | 111,844   |
| Repairs and Maintenance                | 0            | 0            | 0            | 0          | 0          | 0          | 4,915     |
| Supplies and Materials                 | 5,783        | 599          | 599          | 599        | 599        | 599        | 9,785     |
| Travel                                 | 0            | 0            | 0            | 0          | 0          | 0          | 5,637     |
| Utilities and Rent                     | 0            | 0            | 0            | 0          | 0          | 0          | 26,180    |
| TOTAL OPERATING EXPENSES               | 237,964      | 247,037      | 71,448       | 77,558     | 72,031     | 49,362     | 240,389   |
| OPERATING INCOME                       | 141,406      | 1,076,060    | 151,320      | 114,516    | 228,965    | (15,399)   | (239,489) |
| NONOPERATING REVENUES (EXPENSES)       |              |              |              |            |            |            |           |
| Interest Earnings                      | 0            | 0            | 0            | 0          | 0          | 0          | 7,092     |
| Gain(Loss) on Sale of Asset            |              |              |              |            |            |            | 0         |
| TOTAL NONOPERATING REVENUES (EXPENSES) | 0            | 0            | 0            | 0          | 0          | 0          | 7,092     |
| NET INCOME BY PRODUCT                  | \$ 141,406   | \$ 1,076,060 | \$ 151,320   | \$ 114,516 | \$ 228,965 | (15,399)   | (232,397) |
| PROFIT AS A % OF REVENUE               | 5.83%        | 31.54%       | 18.12%       | 20.78%     | 28.83%     | -12.28%    | N/A       |

NOTE: THIS IS ONLY THREE MONTHS' ACTIVITY AND THEREFORE SHOULD NOT BE INTERPRETED TO SHOW HOW OUR PRODUCTS HAVE PERFORMED IN PAST YEARS OR WILL PERFORM IN THE FUTURE.

**MONTANA LOTTERY**  
Notes to the Financial Statements (Unaudited)  
September 30, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting agency.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games, Powerball, Wild Card, Montana Cash, and Hot Lotto are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing. Qwik Tix revenue is recognized at the time of sale by the retailers.

Free Tickets. Some Montana Lottery scratch games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the quarter ended September 30, 2004 was zero.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the quarter ended September 30, 2004, promotional credits resulted in a revenue reduction of approximately \$16,009 and an advertising expense reclassification of approximately \$11,130.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto and Qwik Tix prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. Qwik Tix prizes must be claimed within six months of the sale date. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all games is represented in the table below.

|                     | Quarter Ended<br>9/30/04 | Quarter Ended<br>9/30/03 | Year To Date<br>9/30/04 | Year To Date<br>9/30/03 |
|---------------------|--------------------------|--------------------------|-------------------------|-------------------------|
| Lotto &<br>Qwik Tix | \$125,214                | \$88,027                 | \$125,214               | \$88,027                |
| Scratch             | <u>16,705</u>            | <u>48,847</u>            | <u>16,705</u>           | <u>48,847</u>           |
| <b>TOTALS</b>       | \$141,919                | \$136,874                | \$141,919               | \$136,874               |

## 2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

|                                      | September 30, |             |
|--------------------------------------|---------------|-------------|
|                                      | <u>2004</u>   | <u>2003</u> |
| Short-term investment pool           | \$2,009       | \$122,084   |
| Cash on deposit with State Treasurer | 142,426       | 98,714      |
| Cash in revolving deposit account    | 10,000        | 10,000      |
| Petty Cash                           | 150           | 150         |
| <b>TOTALS</b>                        | \$154,585     | \$230,948   |

Reference to the State of Montana's Comprehensive Annual Financial Report would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$12,415 at September 30, 2004 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include \$1,407,386, representing amounts due the Lottery for tickets purchased by retailers. An allowance for doubtful accounts is reported as net of receivables and is based on historical perspective. As of September 30, 2004 the allowance is zero. An allowance for ticket returns is also included in the receivables amount. This allowance represents a reduction in receivables at September 30, 2004, for estimated ticket returns. This is an estimate

based on returns received to date, as well as, an estimate of tickets unsold by retailers for games that have a public sale end date prior to October 1, 2004. The allowance for ticket returns is \$133,145 at September 30, 2004. The return of vendor fees related to the allowance for returns is \$11,065.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at \$784,223 stored in the warehouse, at retailers prior to being activated by the retailer and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At quarter end, supplies inventories totaled \$53,596. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets consist of the following:

|                   | September 30, |              |
|-------------------|---------------|--------------|
|                   | <u>2004</u>   | <u>2003</u>  |
| Prepaid Expenses  | 25,865        | 24,398       |
| Employee Advances | <u>3,900</u>  | <u>4,800</u> |
| TOTALS            | \$29,765      | \$29,198     |

Transfer Obligations. The account "Transfer Obligations" is \$1,464,472 payable to the General Fund at September 30, 2004.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

| <u>Balance</u>       | <u>Net Leave</u>     | <u>Balance</u>            |
|----------------------|----------------------|---------------------------|
| <u>June 30, 2004</u> | <u>Earned/(Used)</u> | <u>September 30, 2004</u> |
| \$190,739            | (\$6,362)            | \$184,377                 |

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch, Qwik Tix and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of Qwik Tix and lotto tickets sold. For the quarter ended September 30, 2004 commissions totaled \$460,819.

Included in this amount are retailers' bonus commissions on tickets sold based on incremental sales of scratch tickets and Qwik Tix. During the quarter ended September 30, 2004 retailers earned bonus commissions of \$51,431.

### 3. **MARKETING PRODUCTION EXPENSES**

The Lottery has contracted with several vendors to provide marketing related services and materials. These services include media placement, creative design and layout, and media production. Those services and materials not included in the Advertising and Advertising Production expense categories are printing and ticket dispensers. The cost of these services and materials, included in Operating Expenses as Contracted Services and Supplies and Materials, are detailed below for the quarter ended September 30, 2004:

|                              |                |
|------------------------------|----------------|
| Printing                     | \$1,557        |
| Customer Display Units (CDU) | 0              |
| Ticket Dispensers            | 4,350          |
|                              | <u>\$5,907</u> |

### 4. **PAYMENTS TO OTHER STATE AGENCIES**

The Lottery receives a variety of services and supplies and materials from other state agencies. These services and materials are detailed below for the quarter ended September 30, 2004:

|                                 |                 |
|---------------------------------|-----------------|
| Insurance                       | \$ 6,064        |
| Warrant Writing Services        | 89              |
| Payroll Services                | 259             |
| Audit Fees                      | 0               |
| Work Study Contracts            | 0               |
| Computer Fees                   | 6,336           |
| Printing                        | 0               |
| State Accounting System Support | 2,251           |
| Supplies and Materials          | 126             |
| Mail Processing Fees            | 983             |
| Telecommunications              | 4,808           |
| Public Relations                | 0               |
| Administrative Service Fees     | 13,580          |
| SWCAP and SFCAP                 | 3,317           |
| Other                           | 474             |
| <b>TOTAL</b>                    | <u>\$38,287</u> |

5. **PRIZES**

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the quarter ended September 30, 2004, the prize expense of \$4,349,320 is 53.42% of net Lottery ticket revenue of \$8,141,411.

6. **TRANSFER TO STATE GENERAL FUND**

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund." For the quarter ended September 30, 2004, the net revenue payable to the State General Fund totaled \$1,464,472.

7. **MULTI-STATE LOTTERY JOINT VENTURE**

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, and Hot Lotto are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Receivable with a balance of \$1,353,842, as of September 30, 2004 is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). The balance of these reserve accounts is as follows:

|                                     |                    |
|-------------------------------------|--------------------|
| Powerball Prize Reserve Account     | \$661,370          |
| Powerball Unreserved Account        | 46,728             |
| Powerball Set Prize Reserve Account | 194,521            |
| Wild Card Reserve Account           | 415,074            |
| Hot Lotto Set Prize Reserve Account | <u>36,149</u>      |
| <b>TOTAL</b>                        | <b>\$1,353,842</b> |

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid. Interest earned on the Lottery's share of the fund, represented by the Unreserved Account, would be returned to the Lottery upon leaving MUSL. The amounts in the Unreserved Account may be used at the Board's discretion.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball Game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than making a lump sum payment. Payments made to this fund are considered a portion of prize expense associated with the game.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

## **8. GAMES**

Currently, the Montana Lottery games are scratch ticket games, four lotto games referred to as Powerball, Montana Ca\$h, Wild Card, and Hot Lotto and four instant play/instant win games referred to as Qwik Tix.

Scratch ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately \$10 million. A player must match all 6 numbers to win the jackpot; players win prizes ranging from \$3 to \$100,000 for matching less than all 6 numbers. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional bet, the Power Play option provides non-jackpot winners the chance to multiply their prize amount by a factor of two through five.

The Montana Ca\$h game allows players the chance to win a minimum pari-mutuel jackpot of \$20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins \$5 and 4 of 5 wins \$200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of \$100,000. Players select 5 numbers from a field of 31 plus one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from \$1 to \$5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Lottery introduced Hot Lotto on April 7, 2002. Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of \$1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from \$2 to \$10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Qwik Tix is a new product line introduced by the Lottery in February 2004. There are four games, each with its own play style and prize structure. The four games are Lucky Numbers, a number match game; Hot Tac Toe, a tic tac toe grid; Jacks or Better, a poker game; and Montana Match, a match three symbols game. The Qwik Tix tickets are printed at the lotto terminal at the time of sale and can be redeemed immediately, with the maximum prize being \$500. Each ticket costs \$2 and consists of either two plays of a single Qwik Tix game or one play of a Qwik Tix game and one play of a related lotto game. The lotto games sold in this manner are exactly

the same as lotto tickets sold separately and cannot be redeemed until the appropriate drawing.

#### **9. COMMITMENTS - GAMING SUPPLIER CONTRACTS**

Scratch Tickets. On June 27, 2001 the Montana Lottery Commission approved the award of a one-year contract with Oberthur Gaming Technologies Corp. (Oberthur) for the provision of scratch tickets; the resulting contract was signed on August 8, 2001. The contract is for one year with the option for six additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

Oberthur, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$7,500,000. The Lottery may terminate this contract by providing proper notification to Oberthur.

On-line Services. On August 18, 1998, the Lottery signed a seven-year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning March 28, 1999. The contract provides for payments to be made for the purchase of an on-line gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation \$5,025,311 for the system on April 26, 1999. Payment under the contract is also based on 8.35% of weekly Lottery sales.

#### **10. CONTINGENT LIABILITIES - PRIZE ANNUITIES**

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totaling \$5,000,000. The Lottery made the initial payments to the winners in the amount of \$253,088 and on September 26, 1988 the Montana Lottery awarded annuities in the amount of \$2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of September 30, 2004 the contingent liability for future prize payments funded through the purchase of annuities was \$697,500.

#### **11. LOTTO\*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES**

Jackpot prizes awarded in the Lotto\*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds

each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On January 13, 1990 the Montana Lottery awarded its first Lotto\*America jackpot prize totaling \$1,740,000. The first annual payment of \$87,000 was made on February 1, 1990. On May 9, 1990 the Lottery awarded a second Lotto\*America jackpot prize of \$3,000,000. The first annual payment of \$150,000 was made on May 23, 1990. A third jackpot prize was awarded on February 2, 1991 for \$7,360,000. The first annual payment of \$368,000 was made February 15, 1991. On November 23, 1991 a fourth jackpot prize was awarded totaling \$46,967,738.57. The first annual payment of \$2,355,738.57 was made December 12, 1991. On April 11, 1992 a fifth jackpot prize was won totaling \$2,000,000. The first annual payment of \$100,000 was made on April 27, 1992.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling \$700,565. The first annual payment of \$35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling \$31,401,655.99. The first payment of \$1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling \$11,000,000. The first annual payment of \$550,000 was awarded on April 18, 1997.

As of September 30, 2004 the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Lotto\*America winners was \$20,529,731. The combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners was \$22,615,210.

On March 27, 1999 the Montana Lottery had a Powerball jackpot winner. The prize was \$35.1 million (\$19.35 million cash option). The winner chose the cash option and was paid a lump sum in June 1999.

## **12. LEASES**

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a noncancelable lease agreement that is effective March 2002 through February 2007. The monthly lease payments through February 2005 are \$7,366 and will increase 1.5% per year.

13. LONG-TERM DEBT

Note Payable. A contract with Autotote Lottery Corporation required the purchase of an online gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation \$5,025,311 for the system by entering into a loan agreement with Norwest Investment Service, now known as Wells Fargo Brokerage Services, LLC. The loan will be repaid in quarterly installments of \$286,394.30 over five years. The first payment was due July 26, 1999. The interest rate on the loan is 5.12%. The loan was paid in full in April, 2004.

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